❝The restrictions added by banks, in light of the bailout and rise in core capital ratio, have therefore impacted on the way traditional finance is provided.❞

Hugo Rosa Ferreira,
Banking and Finance Partner, PLMJ

gap between sellers' expectations and the requirements of international investors. With distressed assets you can always find buyers, explains Ricou at Cuatrecasas Gonçalves Pereira, but the challenge is getting true value.

And although the international debt capital markets recently reopened to Portuguese issuers, lawyers still believe that the main market players will continue looking towards the international markets in search of funds. There are some international funds looking into Portugal for opportunities to invest through debt and equity instruments, says António Rocha Alves, Banking & Finance Partner at Campos Ferreira, Sá Carneiro & Associados, and the country's existing legal framework can accommodate such an investment. In fact, this framework is extremely favourable to foreign investors, particularly at this moment, notes Nelson Raposo Bernardo, Managing Partner at Raposo Bernardo. This includes specific rules on visas, tax advantages for projects with some dimension, and speed in company incorporation.

Lawyers are also seeing a trend of foreign banks increasing their market share, namely in corporate financing. According to Francisco Ferraz de Carvalho, Counsel at Linklaters in Portugal, there is a great deal of activity in bilateral loans from Chinese Banks to many Portuguese companies, and also some European banks are seemingly willing to lend to top tier companies. "And the recent arrival of Angolan banks in Portugal is significant," says Luís Branco, Banking and Finance Partner at Morais Leitão, Galvão Teles, Soares da Silva & Associados (MLGTS), "although we are yet to know the impact this will have on the domestic market."

While this new financing is good news for the market, ceilings on interest rates imposed by the Bank of Portugal, together with increased withholding taxes, could make investors choose other countries with better ratings to invest their money. "It will then be difficult for banks to help SMEs, due to the imposed target credit/deposit ratio," explains Diogo Leónidas Rocha, Head of Banking & Finance, Garrigues in Portugal, "although some large companies manage to get financed from retail investors by issuing bonds in the local market."

The danger is also that the Government is wanting to show the outside world that it has learned its lessons, and sometimes is adopting a punitive attitude towards private investors. The real challenge for them, according to Ferraz de Carvalho at Linklaters, is striking the right balance between correcting past mistakes and maintaining the credibility of Portugal as an investor friendly country.

Fresh money

Restrictions to the availability of banking credit in Spain, and the critical need for companies to secure finance, have created a breeding ground for the rise of a new type of lender, such as private equity firms or hedge funds, says Foz at Roca Junyent. "The growth of this 'shadow' banking system raises some concerns for its lack of supervisory control, while also highlighting the need to develop specific regulations that deal with the particularities of this activity."

But lawyers are mainly seeing new financing coming into Spain from Institutional investors, pension funds, insurance companies and sovereign funds, says Ana López, Banking & Finance Partner at Freshfields Bruckhaus Deringer. So while the country's banks are at a standstill, the liquidity gap is currently being filled by entities not based in Spain. "And we are seeing that this option is becoming increasingly popular among our clients," adds Guillermo Yuste, Banking & Finance Partner at Araoz & Rueda.

Funds may be one of the best alternatives to fill the liquidity gap, agree lawyers. But they expect high profitability, at least, significantly higher than the consideration that Spanish companies are accustomed to pay to their traditional lenders, explains Rafael Aguilera Álvarez, Banking and Capital Markets Partner at Gómez-Acebo & Pombo in Spain. "And we are not sure if Spanish companies, particularly mid-sized, are ready to pay money for lenders with whom they have no relationship. There is a big cultural difference between Spain and the UK, for example, where the credit funds deal in risk rather than relationships."

Spanish companies, therefore, have a real problem, according to Rafael Mínguez Prieto, Finance Partner at Cuatrecasas Gonçalves Pereira in Spain, because they are having to move into another credit landscape and deal with different types of institutions, jurisdictions and laws, and being subject to increasing supervision. "Those entities that can provide liquidity to Spanish companies have different rules to those that they are accustomed to, and we need to solve the problem of how to combine traditional and alternative financing, different mentalities, rules, objectives and laws. And we have to find solutions from a legal perspective."

Also, if we are struggling with easier financing structures, then there is a question as to how we will deal with future ones that will be far more complex, adds César Herrero, Finance and Projects Partner at DLA Piper Spain. "And some alternative funding transactions abroad are having to be refinanced after only one year, therefore we don't know if in the long-term these structures will be successful at meeting all involved parties' needs and expectations."

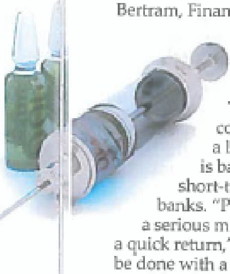
When putting in place these alternative financing structures, aside from the higher returns demanded by the credit funds, the requirement of borrowers to fit the long-term financing provided by credit funds with the short-term financing to be provided by banking entities make for complex negotiations, explains Juan Hormaechea, Finance Partner at Ashurst, meaning that clients also have to factor in higher lawyers' fees.

"And, where you have 'dual law' financing, there is a general increase in the complexity of the transactions," says Ignacio Ruiz-Camara, Finance Partner at Allen & Overy, "which is proving a big challenge for the sector."

Another key factor in allowing liquidity to flow into the market is by facilitating transactions. However, the authorities do not appear to be sensitive to this need. According to Yuste at Araoz & Rueda, the existing indirect taxation on security and certain amendments to the Spanish Insolvency Act in 2011, are often 'deal killers'. The regional authorities, however, tend to increase indirect taxation on security rather than to reduce it, say lawyers, and no steps are being taken to amend Spanish insolvency law so as to remove the existing hurdles.

For smaller and medium sized companies, however, alternative sources of funding aren't an option, and these companies form around 80 percent of the Spanish market. "Their only access is to bank funding and this collapsed for them," says Emilio Díaz Ruiz, Banking & Finance Partner at Uría Menéndez in Spain, "and the only solution is to create some type of tailor-made capital market for these companies."

Ultimately, the question is whether or not companies have a choice when it comes to refinancing. "Where there is no other option because of the existing banking syndicate having to reduce their exposure, they will have to turn to alternative sources of financing," explains Jose Christian Bertram, Finance Partner at Ashurst, "be it credit funds or, if the company has access to them, the capital markets."



Surgery

Therefore, while there is new financing coming into the markets, the majority is on a long-term basis. The challenge, therefore, is balancing long-term financing with clients' short-term needs, which used to be provided by the banks. "People need to start realising that investing is a serious matter, you cannot just take funds and expect a quick return," says Branco at MLGTS. "Investing needs to be done with a long-term vision."

But there is now a unique opportunity for corporates to combine long-term alternative funding with day-to-day traditional financing, according to Ruiz-Camara at Allen & Overy. "And we are seeing a great appetite for bonds, and broadening the range of financial alternatives available in Spain should be seen as a good thing."

Alternative financing has been done in other jurisdictions so there is no reason that Spain should be

❝The banks are still under very strict deleveraging requirements, so they have to shrink their balance sheets and sell off part of their assets, including their non-performing loans, in order to survive and move forward. So liquidity to the market is still very much constrained.❞

Pedro Cassiano Santos,
Banking, Finance and Capital Markets Partner, VdA

any different, says García at Clifford Chance. But until the problems coming out of the restructuring of savings banks are definitively solved, adds Díaz Ruiz at Uría Menéndez, the banking sector will not really be able to go forward.

For the Portuguese economy, the main challenge will be to learn to live without what was its 'oxygen' up until the bailout – bank financing. Deleveraging will continue to be necessary throughout all layers of the economy, says Ferreira Malaquias at Uría Menéndez - Proença de Carvalho, and the faith of the Portuguese economy will be deeply linked to economic and political circumstances at a European level. If the Portuguese State and banks are able to continue to tap the international markets for funds, it may be that the economy gets the oxygen it needs.

Banks need to become active players in attracting foreign investors and convince local ones to invest in existing businesses, according to António de Macedo Vitorino, Managing Partner at Macedo Vitorino & Associados, and corporates need to understand that the easy credit age is gone and that yields for equity and mezzanine investors are much higher than that of mere debt providers.

"The reality is, however, that there is a feeling of resilience, resistance and regeneration, and that we are learning our lessons from the crisis and beginning to understand the concept of efficient investment," says Cassiano Santos at VdA, "although this comes at a stiff price of redundancies, unemployment and insolvencies."

So while both economies continue to suffer, and their banking and finance sectors are still undergoing radical facelifts, alternative financing could prove to be the 'go-to' source of funding until the traditional banking systems get back on their feet.

Regulatory developments – Portugal

The recent major amendment to the Portuguese framework on the reorganisation and winding-up of credit institutions, means the Bank of Portugal now has very extensive powers to intervene in the banks' business, in order to avoid bail-outs with the taxpayers' money, says Ferreira Malaquias at Uria Menéndez - Proença de Carvalho.

It also modifies the General Regime of Credit Institutions and Financial Entities, aimed at recovering institutions in difficulties, or facing liquidation. And the Bank of Portugal has also developed much more of an 'onsite' approach, explains João Caiado Guerreiro, Managing Partner at Caiado Guerreiro, through the establishment of permanent inspection teams in the main banks as well as new methods for evaluating the institutions' risk profile.

This year, therefore, banks will face new and increased challenges from the much stricter supervision with the possibility of stiff sanctions.

Recently Bank of Portugal also put forward a package of regulation, which aims to promote arrears prevention and out of court settlement of such situations arising from credit agreements with consumers, says Nuno Azevedo Neves, Banking & Finance, Corporate & M&A, Tax Partner at ABBC. Namely the Pre-Arrears Action Plan (PRAP) and the Out-of-court Arrears Settlement Procedure (OASP), thus forcing the Banks and Credit Institutions to implement within their organisations both a formal standard PRAP and an OASP. This also promoted the implementation of a nationwide network of support to over-indebted customers, intended to provide advice and assistance in the context of arrears prevention or settlement of any arrears

Finally, Santos Machado at Abreu Advogados notes that the Special Regime on consumer rights, which amended the current consumer credit law, is involving a significant work load for bank's internal legal teams.

Lawyers believe, however, that the Bank of Portugal's measures will reduce the profitability of the banks and the attractiveness of banking sector as an investment destination.